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Inquiry Commission Slams Greenspan, Bernanke, Geithner, Paulson, Summers, SEC, Rating Agencies and Big Banks for Causing Crisis

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The Financial Crisis Inquiry Commission is releasing its report Thursday.

The New York Times has a preview of the report, which shows that the Commission will slam the right people for causing the financial crisis.

Barry Ritholtz gives a good summary of the Times' article:

> The many causal factors highlighted in the FCIC report:
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> • Alan Greenspan's malfeasance — his refusal to perform his regulatory duties because he did not believe in them — allowed the credit bubble to expand, driving housing prices to dangerously unsustainable levels; Greenspan's advocacy for financial deregulation was a "pivotal failure to stem the flow of toxic mortgages" and "the prime example" of government negligence;
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> • Ben S. Bernanke failed to foresee the crisis;
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> • The Bush administration's "inconsistent response" — saving Bear, but allowing Lehman to crater — "added to the uncertainty and panic in the financial markets."
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> • Bush Treasury secretary Henry M. Paulson Jr. wrongly predicted in 2007 that subprime meltdown would be contained.
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> • The Clinton White House, including then Treasury Secretary Lawrence Summers, made a crucial error in "shielding over-the-counter derivatives from regulation [CFMA]. This was "a key turning point in the march toward the financial crisis."
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> • Then NY Fed President, now Treasury secretary Timothy F. Geithner failed to "clamp down on excesses by Citigroup in the lead-up to the crisis;" Further, a month before Lehman's collapse, Geithner was still in the dark about Lehman's derivative exposure;
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> • Low interest rates brought about by the Fed after the 2001 recession "created increased risks" but were not chiefly to blame, according to the FCIC (I place some more weight on Ultra-low rates than they do);
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> • The financial sector spent $2.7 billion on lobbying from 1999 to 2008, while individuals and committees affiliated with the industry made more than $1 billion in campaign contributions. The impact of which an incestuous relationship between bankers and regulators, Congress and bankers, and

classic regulatory capture by the industry.

• The credit-rating agencies "cogs in the wheel of financial destruction."

• The Securities and Exchange Commission allowed the 5 biggest banks to ramp up their leverage, hold insufficient capital, and engage in risky practices.

• Leverage at the nation's five largest investment banks was wildly excessive: They kept only $1 in capital to cover losses for about every $40 in assets;

• The Office of the Comptroller of the Currency along with the Office of Thrift Supervision, "federally pre-empted" (blocked) state regulators from reining in lending abuses;

• The report documents "questionable practices by mortgage lenders and careless betting by banks;"

• The report portrays the "bumbling incompetence among corporate chieftains" as to the risk and operations of their own firms:

> -Citigroup executives admitting that they paid little attention to the risks associated with mortgage securities.
> -AIG executives were blind to its $79 billion exposure to credit default swaps;
> -Merrill Lynch top managers were surprised when mortgage investments suddenly resulted in billions of dollars in losses;

Reuters provides the following synopsis:

> Among regulators the report singles out former Federal Reserve Chairman Alan Greenspan and his successor Ben Bernanke. The report faults Greenspan and his allies for pushing the idea that financial institutions could "police themselves."
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> Bernanke and former Treasury Secretary Henry Paulson were criticized for not seeing the problems in the subprime mortgage markets earlier.
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> Clinton administration officials were rebuked for pushing to shield over-the-counter derivatives from regulation.
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> As for the corporate chieftains at the large financial firms that were either toppled or brought to their knees by the crisis, the panel says its examination found "stunning instances of governance breakdowns and irresponsibility."
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> Among those singled out are American International Group, mortgage giant Fannie Mae and Merrill Lynch.
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> The report faults investment banks Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch and Morgan Stanley for "operating with extraordinarily thin capital" in 2007. "Less than a 3 percent drop in asset values could wipe out a firm," according to the report.
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> The report criticized credit rating agencies such as Moody's Corp, McGraw-Hill Cos' Standard & Poor's and Fimalac SA's Fitch Ratings for giving "their seal of approval" to securities that proved to be far more risky than advertised because they were backed by mortgages provided to borrowers who were unable to make payments on their loans.

> The report also discussed the role played by “shadow banking,” or unregulated financial firms, the securitization of private mortgage debt and over the counter derivatives.

The FCIC places only minor blame on Freddie Mac and Fannie Mae. On the other hand, leading bank analyst Chris Whalen agrees with FCIC Commissioner Peter Wallison (co-director of the American Enterprise Institute’s program on financial policy studies) that Freddie and Fannie’s shenanigans were a leading cause of the crisis. This is the minority view of the FCIC.

Many people – including me – predicted that the FCIC would be a whitewash. However, the fact that the Commission has named some of the big fish who caused the crisis is encouraging.

And the Commission has indicated that it will make criminal referrals. We’ll have to wait and see if the referrals are for big or small fish.